SENATE FISCAL AGENCY

THE VANISHING FEDERAL BUDGET SURPLUS: WHAT HAPPENED?
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The fiscal year (FY) 1998 Federal budget marked a major turning point in the debate over the overall status of the budget. For the first time since FY 1969, the Federal budget closed the fiscal year with a surplus. Thirty years of discussion in the United States Congress as to how to eliminate a Federal budget deficit quickly turned into a discussion as to what to do with a Federal budget surplus. The change from a Federal budget deficit to a Federal budget surplus can be traced to a robust United States economy, modest Federal tax increases enacted in the 1990s, and restraint in Federal spending. However, as quickly as the Federal budget moved into a surplus beginning in FY 1998, a variety of conditions have moved the Federal budget back into deficit during FY 2002. This article provides a brief explanation as to how the Federal budget could move so rapidly from a surplus to a deficit situation.

As previously mentioned, the FY 1998 Federal budget marked the first year since FY 1969 that Federal revenues exceeded Federal outlays. At the close of FY 1998, Federal budget analysts were projecting growing Federal budget surpluses over the next decade. In fact, during January 2001, at the beginning of President George W. Bush's term in office, the nonpartisan Congressional Budget Office (CBO) stated that if current Federal tax and spending policies remained in play over the next 10 years the overall Federal budget surplus would total $5.6 trillion. This CBO report set off a series of actions by Congress that, when coupled with the national economic recession and the tragic events of September 11, 2001, moved the Federal budget quickly back into annual budget deficits.

Table 1 provides a recent history of Federal budget receipts, outlays, and projected year-end balances. The $69 billion Federal budget surplus recorded in FY 1998 marked the first Federal budget surplus since FY 1969 when a surplus of $3 billion was recorded. The Federal budget surplus continued to grow until FY 2000, when the surplus reached an all-time high of $236 billion. During FY 2001, the surplus declined to a level of $153 billion and President Bush's FY 2003 Budget Message released on February 4, 2002, projects a $106 billion budget deficit at the close of FY 2002. Based on the recommended policies and the economic forecasts contained in the President's budget request, the Federal budget will stay in a deficit situation until 2005, when a surplus of $61 billion is predicted.

Table 1
Federal Government Budget
Receipts, Outlays and Year-End Balance
(billions of dollars)

Fiscal Year	Receipts	Outlays	Surplus/ (Deficit)
1997	$1,579	$1,601	$(22)
1998	1,722	1,653	69
1999	1,828	1,703	125
2000	2,025	1,789	236
2001	2,011	1,858	153
2002	1,946	2,052	(106)
2003	2,048	2,128	(80)
2004	2,175	2,189	(14)
2005	2,338	2,277	61

Note: FY 1997 through FY 2001 represent actual figures. FY 2002 through FY 2005 are estimates contained in the President's FY 2003 budget.

The turnaround in the condition of the Federal budget is even more notable when one realizes that when President Bush took office, his own Office of Management and Budget (OMB) was projecting a $282 billion budget surplus at the close of FY 2002. As a result of actions since early 2001, the OMB now is projecting a $106 billion budget deficit at the close of FY 2002. Table 2 provides a summary of how a projection of a $282 billion Federal budget surplus for FY 2002 can turn into a projected $106 billion budget deficit. Four major items have affected this $388 billion deterioration in the FY 2002 budget balance estimate. The first can be related to the impact on the budget of the 2001 Federal tax package which reduced the FY 2002 surplus estimate by $33 billion. The second change relates to the events of September 11, 2001, and the associated spending increases approved by Congress. These spending increases reduced the projected FY 2002 budget surplus by an additional $61 billion. The largest impact on the FY 2002 surplus is the $197 billion of negative adjustments attributable to the slowdown in the United States economy. This economic slowdown has resulted in major reductions in the estimates of Federal revenues and also has had an impact on Federal expenditures by increasing spending in human services programs and spending on Federal interest payments due to the projected declines in budget surpluses. The final item that has affected the FY 2002 budget projections is the $97 billion attributable to the President's proposed economic stimulus package, which has not yet been approved by Congress. The combination of these four items moves a projected FY 2002 budget surplus of $282 billion to a projected $106 billion deficit.

Table 2
The Vanishing FY 2002 Federal Budget Surplus
(billions of dollars)

FY 2002 Surplus Estimate Prior to Adjustments	$282
Changes to Surplus Estimate:	
Enacted Tax Changes	$(33)
Enacted Spending Increases	(61)
Impact of Revised Economic Forecasts	(197)
Proposed Economic Stimulus Package	(97)
Total Changes to Surplus Estimate	$(388)
Projected FY 2002 Year-End Balance	**$(106)**

Source: President's Fiscal Year 2003 Budget

In conclusion, the lesson to be learned from this rapid change in the status of the Federal budget is clear: It is very risky to base long-term budget decisions on 10-year Federal budget forecasts that can prove to be very unreliable as economic conditions change or national tragedies develop. This may lend some support to the practice in the State of Michigan and all other states of basing state budget policy on short-run forecasts which have a much better chance of being accurate as opposed to a long-term forecast.